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Research in Progress 22

**SELECTING PRIORITIES FOR POVERTY REDUCTION
AND HUMAN DEVELOPMENT:
THE CASE OF ETHIOPIA**

Arne Bigsten

August 1999

UNU World Institute for
Development Economics Research
(UNU/WIDER)

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Selecting Priorities for Poverty Reduction and Human Development

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This study has been prepared within the UNU/WIDER project on Underdevelopment, Transition and Reconstruction in Sub-Saharan Africa, which is directed by Professor Tony Addison.

UNU/WIDER gratefully acknowledges the financial contributions to the project by the Government of Italy (Directorate General for Development Cooperation), the Government of Sweden (Swedish International Development Cooperation Agency – Sida), and the Government of the United Kingdom (Department for International Development). These agencies can accept no responsibility for any information provided or views expressed.

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ISSN 1455-3090
ISBN 952-455-029-6 (printed publication)
ISBN 952-455-030-X (internet publication)

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Acknowledgements

A first draft of this paper was presented at the UNU/WIDER project meeting on Underdevelopment, Transition, and Reconstruction in Sub-Saharan Africa, held in Helsinki 16-17 April 1999. The author is grateful to the meeting participants for their comments and suggestions. Further comments and suggestions from Tony Addison were helpful.

This paper is dedicated to the memory of Tadesse Mekonen who was involved in the first stages of this work, but who sadly died during the course of the project.

Abstract

Ethiopia is one of the poorest countries in the world. At least 45 per cent of the population cannot meet their minimum basic needs. Human development indicators are amongst Africa's worst, including a very high level of illiteracy. The country was devastated by prolonged war, and has been reconstructing since 1992. The government has also engaged in economic reform to correct the policy distortions inherited from the Marxist-Leninist government of the Derg. Growth has increased but it has not yet had large benefits for the rural or urban poor. Thus, poverty reduction must be systematically incorporated into Ethiopia's development efforts. Given the scarcity of resources, careful choices must be made, and realistic priorities must be set in order to maximize the benefits of public spending to the poor. Priorities must include investment in the rural road network which will improve the integration of markets (and thus food-security), as well as the development of off-farm employment. Considerable effort must be made to boost the productivity of smallholders through improving the system of input-supplies, better extension, and micro-credit. Within the area of human development, needs are so large, that rapid improvement should be sought through the use of innovations in community-based service delivery. Facilitating informal safety nets, and providing cost-effective public safety nets to offset shocks such as drought, are also priorities. The dismantling of the socialist economic system has made it possible to expand activities of relevance to the poor. But the present war with Eritrea threatens further progress. If it can be brought to an end, the prospects for poverty reduction in Ethiopia are considerable.

Project summary

Underdevelopment, Transition and Reconstruction in Sub-Saharan Africa

This UNU/WIDER project focuses on Angola, Eritrea, Ethiopia, Guinea-Bissau, Mozambique, and Somalia. These countries share a common history; state socialism was the ideology of their early development strategies and liberation movements, and economic failure together with the politics of the Cold War led to intense, and often recurring, conflict. Conflict erupted again in Angola, Eritrea, Ethiopia, and Guinea-Bissau during 1998 and 1999 while Somalia remains highly unstable.

Communities need help to reconstruct, private sectors must revitalize themselves, and state capacities must be built. This is an exceptionally demanding set of tasks given the scarcity of financial resources and skills. Moreover, economic reform is on the agenda for all of these countries, but progress is at best hesitant and, in many cases, stalled. The relationship between reconstruction and reform is also an uneasy one; the two agendas should be mutually supporting but this is often far from the case and in consequence opportunities to accelerate growth and poverty reduction are missed. These failures reinforce the already high vulnerability of these countries to conflict.

Further details of the project and its research outputs can be found on the UNU/WIDER website (www.wider.unu.edu) and/or by contacting the project director, Professor Tony Addison (email: addison@wider.unu.edu).

1. Introduction

Ethiopia is one of the poorest countries in the world. Recent estimates of poverty based on household surveys reveal that 45 per cent of people cannot meet the minimum basic needs defined by an absolute poverty line.¹ In terms of human development, Ethiopia is ranked fifth from the bottom (UNDP, 1997). A civil war that lasted from the 1970s to 1991 (when the Derg was overthrown) left widespread destruction, and required the demobilization of large numbers of fighters (see Ayalew, *et al*, 1999). The socialist strategy of development exacerbated poverty, particularly in rural areas. However, on the positive side, the new government that came to power in 1991 was committed to economic reform, and the period from 1991 to 1998 (when the border war with Eritrea began) at least saw relative peace and stability (on the new war see Hansson, 2000). Ethiopia has made considerable progress with regard to macroeconomic stabilization and growth, but growth has not as yet trickled down to the poorest or reduced poverty significantly. Poverty reduction therefore needs to be systematically incorporated into Ethiopia's development efforts.

The consensus that emerged during the 1980s with regard to the appropriate policy towards poverty is reflected in the influential World Bank *World Development Report* of 1990 (World Bank, 1990). This strategy had three components: labour-intensive growth based on the private sector; public investment in basic education, health and infrastructure; and social safety nets for those that are unable to take advantage of the first two approaches. While this strategy has commanded widespread support, there are a number of difficulties. For example, conflicts of interests tend to surface when one is faced with the trade-offs, which necessarily arise in allocating expenditures for poverty. Moreover, in the 1990s there has been an increasing concern that the conflict between growth and equity is more acute than earlier thought, at least in the short term (Kanbur, 1998). These issues are addressed in this paper in the context of Ethiopia. Moreover, when the budget constraint is very tight, good quality and timely data are especially important in achieving the most poverty reduction from the available budget. The implications of this for Ethiopia are also discussed.

This paper is part of a UNU/WIDER research project that focuses on a group of African countries that are in transition from state socialism and which have a history of conflict. Thus, they must not only reform policy but also reconstruct from conflict and, in some cases, end conflict. The project's overall framework is set out in Addison (1998). The project's intention is to cover all the important issues, but individual papers will focus on one particular topic.² The aim of this paper is therefore to focus on setting priorities for

¹ This estimate is based on a nationally representative income and expenditure survey of 12,000 households conducted by the Central Statistical Authority in 1995 (Ministry of Economic Development and Cooperation, 1999b). Poverty estimates based on panel data for 3,000 households collected by the Departments of Economics at Addis Ababa University and Göteborg University together with the Centre for the Study of African Economies (Oxford University) are similar (Ayalew, *et al*, 1999, Departments of Economics, Addis Ababa and Göteborg Universities, 1998). See also Getahun Taffesse (1998).

² Thus for Ethiopia, Alemayehu Geda (2000) discusses economic reform, Ayalew, *et al* (1999) discuss demobilization and its impact, and Bevan (2000) analyses fiscal issues. For Eritrea, Hansson (2000) discusses reconstruction and reform at the national level, while

poverty reduction. In particular, what are the key priorities if the aim is to raise Ethiopia's human development indicators? What are the most important priorities when resources are limited?

The structure of the paper is as follows. Section 2 sets out some theoretical starting-points and then discusses the macroeconomic situation and the pattern of growth in an attempt to identify the resource constraints within which to compare policy options. Section 3 briefly describes the pattern of poverty, while Section 4 reviews existing public sector priorities and patterns of expenditure. We then discuss the policy areas that are especially important for poverty alleviation, namely infrastructure (Section 5), human capital (Section 6), social safety nets and targeting (Section 7). Section 8 emphasizes the importance of institutions and governance structures. Section 9 concludes the paper by summarizing the many challenges that still exist, and highlights the importance of resolving the present conflict with Eritrea to the resumption of growth and poverty reduction.

2. Macroeconomics and the pattern of growth

The Ethiopian civil war had very serious economic consequences. It destroyed productive assets, created social disorder, diverted resources from output-enhancing activities, and led to dissaving as well as a process of asset substitution, including the shift of assets abroad (see Ayalew, *et al.*, 1999, and Hansson, 1995).³ Empirical estimates of the growth impact of civil wars presented in Collier (1999) indicate that Ethiopia's GDP level in 1990 was some 30 per cent below what it would have been if peace had been preserved. In general, once a society returns to peace, the economy should improve - as destruction, disruption, diversion and dissaving cease - but how it does so depends in part on the nature of the conflict. If the war has been a long one, as was the case in Ethiopia, the asset composition will have had time to adjust to the structure that is optimal in the war environment. Therefore, the restoration of peace should imply a reversal of the asset substitution effect. We would thus expect a peace dividend.

But there are also factors that make it difficult to restart growth. Once peace is restored, the costs of economic activity are reduced – for example transactions costs fall - but it is hard to restore activity back to its pre-war level (particularly in smallholder agriculture where households are very constrained by a lack of capital). It also takes time to reverse the wartime diversion of resources from production to military use. It is politically difficult to cut military expenditures, and this can slow the reallocation of public spending to poverty reduction. Furthermore, during the closing stages of civil war, governments often pursue a desperate and irresponsible fiscal policy leading to large fiscal deficits; this hinders the restoration of productive public expenditures. In Ethiopia's case the fiscal deficit was over 8 per cent of GDP by the time of the Derg's fall. The policy legacy therefore constrains investment. Moreover, war – and the risk of a new war – increases investment risks. This, together with war's negative effect on social capital (social polarization, family fragmentation etc.) reduces the scope for new capital formation (Addison, 1998).

War not only affects the level of GDP it also changes its composition (see Addison, 1998,

Kibreab (2000) analyses the issues at the community level.

³ See Collier (1999) for an analysis of the impact of civil wars on economic growth.

Collier, 1999). Capital-intensive activities - or transactions and activities supplying them - tend to shrink. Thus sectors such as manufacturing, construction, transport, distribution, and finance will shrink relative to GDP during a civil war, while subsistence agriculture will expand (or at least decline by a smaller amount). This provides some cushion for the poor, since their income will probably show less of a decline than the income of the better-off.⁴ However, this pattern should partially reverse itself with the restoration of peace, since it is the capital- and transactions- intensive sectors that will benefit the most from the end of war. This implies that the poorest will be slow to gain from the restoration of economic growth.

Since Ethiopia is one of the poorest countries in the world it will not be possible to achieve significant poverty reduction unless there is economic growth. A basis for any strategy will therefore have to be policies that promote growth. In the first few years after 1991, the economy suffered from the residual effects of the war, but once a measure of stability had been achieved the peace dividend started to materialize. Growth has been high since 1994/95 apart from a large drop in 1997/98 due to bad weather (see Table 1). After 1998, the economy started to suffer the effects of the new war with Eritrea. Inflation is very low, despite a relatively rapid expansion of the money supply (Ministry of Development and Economic Cooperation, 1999a). Capital formation picked up and was 20 per cent in 1997/98. However, the trade deficit has been stuck at over 10 per cent of GDP. There has been some improvement in exports, but transfers largely cover the trade deficit. The exchange rate has therefore been fairly stable for most of the post-1992 period (although it came under pressure after the start of the war with Eritrea in 1998) following devaluation over 1992-93 to correct the severe overvaluation of the currency that was inherited from the Derg (see Alemayehu, 2000).

The fiscal position is important to our discussion of the government's scope for poverty reduction measures (see also Bevan, 2000). The large fiscal deficit that was inherited from the Derg has been brought under control (see Table 1) and by 1997/98 the fiscal position was fairly strong compared to that of other countries in the region - total expenditures were 23.6 per cent of GDP in 1997/98. However, the budget is very low in absolute terms. Per capita income was \$100 in 1996, compared with the Sub-Saharan Africa (SSA) average of \$ 490 (all data are in US dollars). This means that the budget per capita is only \$ 23.6 per year. It is unlikely that public revenues will increase significantly (even after current efforts to improve tax collection) or that already high aid inflows will increase; thus the government will have to operate within a very tight resource constraint. This will only relax once the economy achieves sustained growth. In the meantime, the war with Eritrea is tightening the government's resource constraint since military expenditures have increased over 1998-1999.

Thus, growth must remain a top priority. But its structure should be such that the poor benefit as smallholders, micro-entrepreneurs, and wage-employees. Since the majority of the poor make their livelihood in agriculture, the development of this sector must be emphasized. When policy makers design policies to stimulate growth they must incorporate appropriate analysis of their distributional impact while at the same time emphasizing

⁴ This pattern seems relevant to Ethiopia, but it may not hold in all civil wars. When there is extensive destruction in rural areas – the cases of Angola and Mozambique - the poor may be more adversely affected than the better-off (see Addison, 1998).

policies that are of especial importance to the poor. Those specific policies can be divided into two broad classes; measures to increase the incomes of the poor (such as rural infrastructure and the modernization of agriculture), and measures that improve the quality of life of the poor directly - such as the provision of health care, potable water supplies, and primary education. This paper does not discuss the macroeconomic strategy of Ethiopia (see instead Alemayehu, 2000, Bevan, 2000): this is taken as more or less given. Instead the focus is on what can be done within that context to achieve poverty reduction.

Table 1: Macroeconomic indicators 1990/91-1997/98

	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98
GDP growth rate (%)	-4.4	-3.7	12.4	1.7	5.4	10.6	5.6	0.5
Sectoral distribution of GDP (%)								
Agriculture	56	56.4	53.4	50.6	50	51.5	50.5	46.5
Industry	9.2	9	10.3	10.8	11.1	10.7	10.9	12
(Manufacturing only)	(2.8)	(2.9)	(3.8)	(4.2)	(4.4)	(4.3)	(4.3)	(4.8)
Distributive services	11.9	12	13.2	13.7	13.9	13.6	14.1	15.3
Other services	22.8	22.4	23	24.7	25.2	24.1	24.4	26.3
Inflation rate (%)	20.9	21	10	1.2	13.4	0.9	-6.4	2.3
Gross domestic expenditure as % of GDP at current prices								
Consumption	97	97	94.3	94.9	93.3	93.4	91.7	90.9
(Government only)	16.7	10.1	10.5	11.1	10.8	10.9	11	11.3
Gross fixed capital format.	10.4	9.2	14.2	15.1	16.4	19.1	19	20.2
Resource gap	-7.4	-6.2	-8.5	-10	-9.7	-12.5	-10.7	-11.1
Fiscal data (as shares of GDP)								
Domestic revenue	14.1	10.6	12.0	13.9	17.5	18.4	19.2	18.5
External grants	2.4	2.6	1.7	3.5	3.3	2.9	3.6	3.7
Total expenditure	25.3	20.2	19.5	25.0	24.8	26.9	24.1	23.6
Recurrent	19.0	15.6	12.9	15.5	15.4	14.7	13.8	12.8
Capital	6.3	4.6	6.7	9.5	9.3	9.4	10.4	10.1
Fiscal deficit incl. grants	-8.8	-7.0	-5.9	-7.6	-3.9	-5.6	-1.3	-1.4
Fiscal deficit excl. grants	-11.2	-9.6	-7.6	-11.1	-7.3	-8.5	-4.9	-5.1
M2 growth (%)	18.6	13.1	16.7	10.2	26.9	8.3	5.7	12.7
Trade balance % of GDP	-8.1	-7.2	-13.1	-13	-11.2	-16.6	-12.5	-12.2
Current account incl. off. transfers % of GDP	-6.3	-3.8	-3.4	-1.4	-3.6	-3.4	-3.4	-1.5
Exchange rate (Birr/\$)	2.07	2.07	4.27	5.8	8.25	6.32	6.51	6.88

Source: Data from the Ministry of Economic Development and Cooperation

3. Patterns of poverty

Poverty may exist because of low average incomes or because of an inequitable distribution of income or both. Poverty reduction can therefore be addressed either by policies to achieve faster growth in total income and/or by redistributing income to people at the bottom of the income distribution or a policy to increase the incomes of the poor directly. In this regard, one of the striking features of poverty estimates for Ethiopia is the high ratio between the absolute poverty line and the mean income of the population. Indeed, in recent estimates this value is close to one, implying that per capita income is equal to the minimum cost of basic needs in Ethiopia. This means that sustained economic growth is necessary for Ethiopia to be able to fight poverty in a meaningful way. The question then is what form the efficiency-equity trade-off takes in Ethiopia. If efficiency, or higher growth, can only come at the cost of higher inequality, then we face a dilemma. The evidence regarding this trade-off is mixed.

Whether the incidence of poverty is higher in rural areas than in urban areas is a contentious issue. A recent government study suggests that this is the case (see Ministry of Economic Development and Cooperation, 1999b). But estimates using panel data for 1994-1997 and the poverty line estimates derived by Mekonen Tadesse *et al* (1998) suggest that the incidence is actually higher in urban areas. However, since 84 per cent of the population live in the rural areas, it is clear that most of the poor are to be found there. The extent of urbanization has, however, increased rapidly over the last decades. During the war migrants were largely refugees, who were forced to leave the rural areas. They often arrived in the urban areas without any assets, which explains why they often live in poverty. Thus, the incidence of urban poverty has increased.

During the early 1990s, agricultural production fell, but since then the agricultural sector has more or less kept pace with the rest of the economy; this implies that average rural incomes have increased. Estimates of changes in the rural income distribution are still uncertain.

Estimates from urban surveys conducted between 1994 and 1997 suggest that unadjusted household income increased by 5 per cent, while income per adult equivalent increased by as much as 16 per cent (Bigsten, *et al*, 1998). Income growth was very uneven across income groups; it ranges from a decline of 7.7 per cent for the bottom quintile to an increase of 10.1 per cent for the top quintile if household income is used, while with per adult equivalent income all groups see some improvement - from 2.2 per cent in the bottom quintile to 23.8 per cent in the top quintile. These differences notwithstanding, it seems that growth mainly benefited better-off urban households and that it has not significantly trickled down to poor households. Looking at the pattern of incomes by quintile we see that the poorest quintile relies heavily on female household business income and remittances (and also on children's income). Among households in the top range, incomes from regular businesses are very important. The income growth of the top quintile has thus benefited from the increasing scope for business – this accords with our theoretical starting point which emphasizes the recovery of transactions-intensive sectors. The estimates also show that there has been some increase in urban inequality, which supports the inference that the income increases have been concentrated on the better off. This has been compounded by the fact that demobilized soldiers who returned to the urban areas had few marketable skills and faced a weak job market in the early 1990s (see Ayalew, *et al*, 1999).

The government now faces the daunting task of achieving poverty reduction with extremely limited resources. In the next section we review its priorities up to the present time.

4. Public sector expenditure priorities

Ethiopia has received a large amount of programme aid, and the government has been on generally good terms with the IMF and the World Bank. It has met most of the performance criteria, although there has been some slippage in external payments. Financial reform has been a contentious issue with the IMF (see Alemayehu, 2000). The government has for some time managed to avoid exceeding the spending limits agreed with the BWIs, but this will be impossible to sustain given the new war with Eritrea. The government may try to disguise war expenditures in order to satisfy donor demands. One way to do this is to buy arms on credit from foreign suppliers; the costs will show up later in the budget in the form of foreign debt service. It therefore remains to be seen what the ultimate economic impact of the new war will be. With these macroeconomic points in mind, we now concentrate on poverty reduction measures.

It is useful to distinguish between the short and long term dimensions of poverty eradication. In the short term, measures to support agriculture should receive top priority. Road infrastructure – especially in rural areas – is an investment with high social returns. Rural households without access to roads that connect them to the economy's core will not be able to access markets for inputs or outputs, nor access public services such as extension (see section 5 below). There are also direct measures that can raise smallholder productivity such as small-scale irrigation, extension and agricultural research – these are now underway, but much more can be done. Reducing the maze of regulations that constrain entrepreneurs in Ethiopia is another short-term priority for agriculture and urban enterprises. Informal activities seem to be expanding, while formal activities face many constraints (Wolday Amha, *et al*, 1997).

In the long term the top priority is probably education – especially primary education but also adult education. The adult illiteracy rate is 59 per cent for males and 71 per cent for females (see section 6 below). The dismal educational status of the population is stark evidence of decades of neglect, and Ethiopia is almost unique in the poor level of its educational attainment (Senait Seyoum and Alemayehu Seyoum, 1998).

Looking at the structure of public expenditures we observe some interesting changes during the 1990s. First, defence expenditures fell from over 40 per cent of recurrent expenditures in the second half of the 1980s to an average of about 14 per cent after the fall of the Derg (Table 2). However, this share is now growing as a result of the war with Eritrea. General administration accounts for another 35 per cent of recurrent spending (down from 52 per cent in the 1980s). Thus, after defence spending and general administration, half the budget is left for development and other expenditures. Among economic services, agriculture and water have increased their share of recurrent expenditures: this is a positive development from the poverty perspective. To optimize the poverty impact of the agriculture budget, priority should be given to food-security in poor regions rather than to cash crop farming. The increase in the share of education and health in recurrent expenditures is also a positive development. With regard to capital expenditures there has been a strong increase in the share of road construction which is an appropriate emphasis (see section 5). Investments

in both education and health are growing. However, the reduced emphasis given to investment spending in agriculture is worrying. Nevertheless, most of the changes in the structure of public spending are in the right direction. In the remainder of the paper we discuss in more detail what can be specifically done to maximize the poverty impact of the government's limited resources in these priority-spending areas.

Table 2: Shares of recurrent expenditure by functional classifications 1985/86-1997/98 (percentages)

	85/86-90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98
1. Administrative and general services	51.6	32.1	33.0	30.0	29.0	34.9	32.6	35.2
Defence	41.2	19.2	19.3	14.7	13.5	13.8	14.6	14.6
Others	10.4	12.9	13.7	15.3	15.5	21.1	18.0	19.1
2. Economic services	5.5	7.4	9.5	9.9	9.9	11.1	10.9	10.8
Agriculture and water	3.0	4.1	4.9	5.5	5.9	6.9	7.2	8.1
Construction	1.6	2.1	2.4	2.4	2.7	2.8	3.0	1.2
Others	0.9	1.2	2.2	1.9	1.3	1.6	1.5	1.6
3. Social services	17.9	23.9	27.2	26.9	24.6	25.5	26.2	28.8
Education	11.9	14.8	17.2	16.4	15.1	16.9	18.0	19.7
Health	3.5	4.6	5.4	6.2	5.4	5.9	5.8	6.6
Others	2.5	4.5	4.7	4.2	4.0	2.7	2.3	1.5
4. Various expenditures	16.4	24.3	26.5	32.5	32.8	43.8	25.1	25.2
Public debt	10.2	10.9	17.5	24.1	23.4	16.5	16.1	16.2
Subsidy	2.2	1.8	0.2	1.9	3.7	3.1	2.2	00
Pension	4.0	5.9	6.5	6.1	4.8	5.2	5.3	5.5
Others	0.1	5.7	2.3	0.4	0.8	1.1	1.5	3.4
5. External assistance	8.6	12.3	3.8	1.2	3.7	2.6	4.5	00

Source: Data from the Ministry of Economic Development and Cooperation

Table 3: Capital expenditure by sector 1985/86-1997/98 (% shares)

	85/86-90/91	91/92	92/93	93/94	94/95	95/96	96/97
1. Economic development	90.8	88.4	84.5	73.3	77.5	76.1	74.9
Agriculture	22.6	25.4	18.3	13.9	9.3	11.1	5.9
Mining	7.2	7.4	3.8	4.2	1.9		
Energy	13	7.3	4.5	4	6.6	13.8	16.6
Natural resources & settlement	15.6	10	17.8	12.9	14.7	12.5	9.7
Industry	14.3	15.4	17.3	9.8	10.4	10.7	7.7
Commerce & tourism	0.7	0	0.4	0.1			
Road construction	6.3	6.4	11.1	16.5	23.7	18.2	24.1
Transport & communication	8.1	7.1	7.9	9.6	5.9	5.4	10.9
Financial agencies	2	3.1	3.4	2.2	5	4.4	
Construction	0.8	0.3	0.1	0			
2. Social development	6.9	9.6	14	23	16.1	19.2	19.5
Education	3	4	7.5	9.5	8.5	11.4	9.9
Health	2.4	3.9	3.4	2.5	3.8	3.7	5.4
Urban dev. & housing	1.2	1.4	1.4	6	3.5	3.6	3.8
Manpower development	0						
Social welfare	0.2	0.1	1.3	4.8	0.1	0.2	0.2
Culture & sports	0.1	0	0.1	0.2	0.2	0.3	0.2
3. General services	2	1.6	1.3	3	5.9	4.4	5.4
Mapping	0.2	0.3	0.1	0.3	0.2		
Statistics	0.1	0	0.3	0.8	0.6		
Dev. projects study	0	0	0	0	0.3		
Science & technology	0.2	0.3	0.3	0.1	4.8		
Public administrative building	1.6	1	0.5	1	0.5		
Others	0.3	0.4	0.2	0.7	0.5	0.3	0.2
4. Compensation payments	0.3	0.4		0.7		0.3	0.2

Source: Data from the Ministry of Economic Development and Cooperation

5. Infrastructure for poverty reduction

Rural development is crucial for poverty reduction, but it is of course closely linked to the development of the entire economy and it is therefore futile if macro-economic disequilibrium exists. Thus the achievement of macro-economic stability over 1992-98 has been largely positive for rural development. Agricultural development is critical, not only in improving food security and providing a source of cash income, but also in creating a demand for the services and products of the non-farm rural economy. The two sectors are thus mutually supporting. Ethiopia's smallholders typically diversify their activities in order to reduce their dependence on rain-fed agriculture. Therefore the welfare of the rural poor partially depends on development outside the agricultural sector, including the growth of urban income-opportunities and the associated remittances back to rural areas.

Roads

Roads should be a high priority in a poverty-oriented development programme. Without access to the rest of the economy rural communities will be unable to sell their produce or they will receive low prices because of high transport and marketing costs. Feeder roads are particularly important in this context. Good rural roads have a significant impact on agricultural output, possibly greater than that of producer prices. Good transport infrastructure is also a prerequisite for the provision of banking facilities and other supporting commercial infrastructure in rural areas.

A major policy question is whether road construction and maintenance can be locally based thereby generating much needed off-farm employment. Road maintenance requires more organizational skills than road construction. For many reasons it is desirable to decentralize such activities; for example maintenance needs to be closely supervised and local authorities are better at this than central authorities. Local communities should also have a say in decisions on local road investments. Asian experiences suggest that this increases the utilization of local resources and improves the supervision of construction and maintenance. The actual construction and maintenance can be contracted out to private firms thereby stimulating private-sector development – a critical objective in Africa's transition economies. But decentralization requires effective institutional structures in the regions. This is a major problem in Ethiopia as in other reconstructing economies (such as Guinea-Bissau and Mozambique); most of the skilled administrators are engaged in central government while local authorities are short of skills.

Water, fuel and electricity

The gender dimensions of poverty are important. Hadera Tesfay (1999: 4) notes, for example, that women work double the hours of men – and more than double in the peak season. They fetch water and collect fuel wood, cook, clean, and take care of children in addition to the time they spend in direct production. In some areas a round trip to collect water may take up to six hours and to fetch wood eight hours. Women undertake 30-40 per cent of agricultural labour. One important measure to ease the workload of women is to establish a water supply close to the community. This will also ease the workload of girls in the household and free up time so that they can attend school. The electrification of Ethiopia has barely begun, and probably only 5 per cent of the rural population has access. Electrification obviously is essential to the creation of a more diversified rural economy, and the development of new employment sources.

Credit

Credit programmes for smallholders and urban and rural micro-entrepreneurs may have an important role to play, although experiences with agricultural credit in SSA have not been particularly encouraging – so far. The most feasible option may be seasonal credit: that is also what is most immediately needed. Longer-term loans require collateral, and since land remains state-owned in Ethiopia, most smallholders lack enough assets to borrow. Some institutions are lending money on the basis of other types of business assessments. NGOs are attempting to set up micro-finance schemes. UNDP has a special programme of support to agricultural development, including a fund to deliver credit services particularly to poor women in the regions. Loans to women are typically provided for investments in dairy

farms and the rearing of goats, sheep and poultry. Women beneficiaries are also given training in bee-keeping, nutrition and improved technologies (Hadera Tesfay, 1999: 7).

According to the 1997 survey of cottage/handicraft manufacturing industries conducted by the Central Statistical Authority, about 1.3 million people are engaged in the sector – with about 58 per cent in rural areas.⁵ About 65 per cent of micro-entrepreneurs are female. Again there is a need for micro-credit support to women. Since the majority of Ethiopian women have no formal education, they typically engage in informal sector activities such as petty trading and food preparation which they can start with limited capital or skills and at the same time combine with their family obligations.

Extension services and input supplies in agriculture

Teaching improved cultivation methods is important to raising Ethiopia's generally low agricultural productivity. So far extension services are provided to only a minority of farmers; the Group of 2000, a Japanese NGO, plays a large role. NGOs cannot substitute for an effective state and the government is wary of using NGOs. But given the lack of state resources, and given the high profile of NGOs in Ethiopia, there may be gains to be had from more collaboration. There has been some positive movement in this direction: in March 1999 a code of conduct was agreed upon between the government and the NGOs of Ethiopia.

The supply of fertilizers has improved somewhat, but only a minority of farmers apply it. A more extensive and more effective supply network is urgently needed. So far co-operatives and state agencies have been deeply involved in this, but the government does not have the financial or administrative capacity to manage a nation-wide system. In future the private sector will need to play a greater role and private agents should be assisted by the government and donors through training and other measures. A better system for supplying improved seeds to smallholders should also be developed. In summary, there is much still to be done to improve the productivity of Ethiopia's smallholders, and to achieve food security.

6. Human capital development

It is generally believed that investment in education is a prerequisite for increased economic growth. However, the picture is more complex: many less-developed countries have grown fast without much investment in education, while others that have made substantial investment have seen limited progress. For example, in the case of Kenya, returns to primary education have fallen to very low levels over the last decades (Appleton, *et al*, 1999). Estimates of Mincerian returns to primary education in Ethiopia yield returns of only 3.3 per cent in a state firm and a negative return in a private firm (Wolday Amha, 1998), while Bigsten and Makonnen (1999) find the urban rate of return to primary education to be 6.6 per cent. Moreover, it is not clear that education always raises farm productivity in Africa (Bigsten and Kayizzi-Mugerwa, 1995).

⁵ ILO estimates that between 1.4 and 1.7 million people depend on urban informal sector employment for their main source of livelihood. Women make up 52 per cent of the urban informal work force, and 65.57 per cent of operators.

The question therefore is why returns to primary education are so low. The answer lies on either the demand side or the supply side. In the Kenyan case it seems that demand has not kept up with the increase in supply, and this has driven down returns. It thus seems obvious that by itself education is not sufficient to generate growth, if other conditions are not conducive to growth. Thus while education is important for growth, it will not yield high returns unless complemented by other factors. In the case of Ethiopia the level of adult illiteracy is extremely high (59 per cent for males and 71 per cent for females) and enrolment rates are low, so one would assume that there has not been a drop in returns to education comparable to the Kenyan decline. The second explanation has to do with the education system itself. It is a general perception that the quality of education has gone down due to the lack of resources for education. The conflicts that have ravaged Ethiopia have also contributed to the decline in quality. It may also be the case that the type of education that is provided is inappropriate for finding employment (Wolday Amha, 1998).

There is an urgent need to improve the education of girls. The enrolment rate of girls has increased in Ethiopia, but it is still lower than that for boys. Thus the shares of girls are 35.7 per cent, 42.5 per cent, 41.5 per cent, and 14 per cent respectively in primary, junior secondary, senior secondary and higher education. There are several reasons for the low educational attainment of girls. In rural areas, parents are uncomfortable about their daughters' security if they have to travel long distances and this reduces enrolment and attendance substantially. Since girls are often involved in household duties - such as caring for younger siblings, food preparation, fetching water, collecting firewood - they are less likely to attend schools as the opportunity cost to the family is too high. Many households, particularly in rural areas, give priority to the future role of girls as mothers and wives and formal schooling is seen as largely unimportant to these roles. This has a negative influence on persistence and performance once the girls are in school. Finally, the character of education provided is also important. It has been shown, for example, that girls do better and stay longer in schools if women teach them.

The coverage of the regular educational system in Ethiopia is thus extremely poor and, as we have noted, the budgetary resources of the government are very limited. Therefore some organizations have started experimenting with alternative forms of education. Action Aid's ACCESS (Appropriate Cost-effective Centres for Education within the School System) programme provides a route into the formal system for children - especially for girls - and thus supports the regular system of education (Ahmed Ali, 1997). It focuses on the lower grades 1-4 and the teaching methodology is simple - the teachers are called facilitators - as are the physical facilities. The projects are pilots and are of a limited scale, but ACCESS is intended to become part of future community activities and the approach may provide the best available short cut to expanding the country's otherwise dismal educational coverage.

It will take a considerable time before the bulk of the population has a basic education. This means that development strategies which require educated labour, such as growth through manufacturing labour-intensive exports, will not be viable in the short run. For the time being, development strategy must emphasize the employment of those without education. In the case of Ethiopia this may require a focus on food production, since grain and other foods can be produced with a reasonable degree of efficiency by the poorly educated.

Nevertheless, for long term growth - and thus long-term poverty reduction - it is hard to envisage anything more important than education. It will certainly not be possible to achieve a broad based and sustainable growth process with an essentially illiterate population. The Education and Training Policy of 1994 aimed to restructure and expand the education system, make it more relevant to the present and future needs of society, and achieve the target for universal primary education by the year 2015. (Hadera Tesfay, 1999: 11). These are worthy goals but to achieve them will require larger budgets for basic education and greater community participation through programmes such as ACCESS.

Health

The health status of Ethiopians is low, although there has been some improvement in the 1990s: infant mortality was 124 per thousand in 1990, but fell to 109 in 1996. Under five mortality fell from 196 to 177 over the same period (World Bank, 1998). Life expectancy at birth increased from 46.5 to 49.5, which is in contrast with some other African countries where life expectancy has turned down again in the last few years. Still, the need for improvement remains vast. Moreover, some 2.5 million Ethiopians now suffer from HIV/AIDS (Hadera Tesfay, 1999:16) and the prevalence among pregnant women has reached 18 per cent. This is going to strain the health care system even further.

Per capita expenditure on health services is among the lowest in the world: over the 1990s it averaged \$1.4 per year per capita. Clinics are few and many people have to travel far to use them – thus raising the opportunity costs to households of seeking medical help – and they often lack drugs and equipment. A survey done in 1995 showed that more than a quarter of the rural health facilities lacked a refrigerator and more than 50 per cent of the facilities were missing 25 per cent or more essential drugs (Collier, *et al*, 1997: 6).

Given the resource constraint, very careful choices must be made. The government has focused on the serious lack of primary health facilities and its strategy is to invest in new facilities; the plans suggest doubling the number of facilities. Consequently, the capital budget for health has been increased, but this has been done at the expense of the non-salary recurrent budget, which has been seriously squeezed. The quality of service, already among the lowest in SSA, does not therefore show much improvement.

The study by Collier, *et al* (1997) uses a large-scale survey of rural households to analyse their behaviour in the area of health services; they find that household usage of health facilities is much more sensitive to their quality than the household's distance to the facilities. They draw the policy conclusion that it would be much more cost effective to raise the quality of existing facilities than to continue with the building programme. Indeed, they argue that the same effect in terms of household health could be achieved at a fifth of the price of the building option. There would also be other health benefits of improved quality apart from the actual increase in usage.

The choice here is thus between capital expenditures and recurrent expenditures. However, the Ministry of Development and Economic Cooperation controls the former, while the Ministry of Health controls recurrent expenditures on health. Making the trade-off, and setting priorities, is therefore not straightforward. Moreover, donors prefer to finance facilities and argue that the government should finance recurrent costs. A bias towards expanding the number of facilities therefore exists and this may aggravate the problem of

lack of funding for recurrent costs by extending the system without increasing the funds of the Ministry of Health.

One potential way to increase usage is to introduce user fees, the revenue from which is then allocated to increase quality of service. This may well be possible, but many households would obviously find it hard to pay and user-fees, if introduced, would need some administrative system to exclude the very poorest from obligation to pay. However, here we run into the usual institutional problems as well as the problem of Ethiopia's weak institutional capacity to make such a system work effectively. User charges are therefore no panacea for the quality problem.

7. Social safety nets and targeting

Two types of safety nets are required. First, destitute people need long term support, while other categories need support when they are exposed to negative shocks. Since the number of chronically poor people in Ethiopia is huge, it is difficult to envisage a system of general individual transfers that can effectively help this group. Moreover, many of the hardcore poor are largely subsistence farmers, which means that they are not helped in the short run by shifts in the urban-rural terms-of-trade in favour of agriculture. To help this group, attention must focus on raising their productivity and improving their market access, as well as improving their access to basic social services. Given the administrative decentralization (see Bevan, 2000), differences in regional poverty levels should be a factor in allocating budgets across regions. Thus, given the high concentration of poverty in some regions, there is scope for regional targeting. There is a strong case for fiscal transfers to the poorest regions, although this may be politically difficult given the country's history. Still, this may be one of the few feasible ways of targeting the poor, but this of course requires that the district administration can effectively deliver services to the poor. Within the overall framework of regional targeting, there is also need for local targeting. Elderly and children, particularly orphans, are appropriate for targeting. Also, the sick and disabled are in need of targeted support. Regional targeting can be done on a governmental level, but local targeting of households requires much more detailed local knowledge.

A system to guarantee food security is also a priority. The government estimates that 52 per cent of the population is food insecure. It is well known that Ethiopia is unusually exposed to the vagaries of nature and there have been several famines in the last few decades (Sen, 1981). Indeed, famine struck again in 1999. Farmers lose their effective purchasing power and public works programmes are one means to put food or cash in the hands of the poor while at the same time creating local infrastructure (Ravallion, 1991). The World Food Programme is active in this area in Ethiopia. However, the experience with such self-targeting mechanisms has not been fully satisfactory in Ethiopia. Jayne *et al* (1999) analyse the targeting of food aid in rural Ethiopia, based on a national sample for 1996. Their study investigates whether food aid - both in the form of free distribution and as food for work - is actually targeted to poor communities and poor households. The policy is that about 80 per cent of the funds should be allocated in the form of food for work, but de facto it has been less than half. They also note that wages in the food for work system have been above rather than below market wages, which has meant that self-selection has not worked very well.

There does exist a system to collect information about the need for food aid. This was developed during the Derg period in response to the famines of that time. Information flows up from the wereda level through the bureaucratic structure to the central government authority (the Disaster Prevention and Preparedness Commission), which then determines the regional allocation. This is then sent back through the system to the weredas. Within the weredas the allocation of food aid to households is the responsibility of the wereda administration assisted by community representatives such as the peasant associations. It is the PA leaders that finally implement the plan.

Has the existing system for information gathering and processing been able to satisfactorily target food aid? The evidence indicates that there is some targeting of the poor, but nevertheless major allocations go to areas that are not among the poorest (Jayne, *et al*, 1999). This may be due to the fact that the selected areas are chronically needy. Alternatively, it may be due to the existence of fixed costs in setting up distribution systems leading to inertia in the location of food aid programmes. Their regression analysis tends to support the latter explanation. The single most important determinant of whether a wereda or a household gets food aid is whether they were recipients earlier. It may also be noted that communities in Tigray have a much higher probability of being selected given their economic status, which suggests a political bias. There is an inverse but not very strong correlation between per capita income and the probability of receiving both types of food aid. Also high-income households have a good chance of getting food support. The probability of getting food aid is weakly responsive to weather shocks, but the amounts are not. Thus, high fixed programme costs plus successful political lobbying seem to explain much of the existing allocation of food aid. The results of this study show that it is difficult to achieve effective targeting in a poor and politically unstable environment

8. Institutions and governance

Ethiopia has a history of a socialist dictatorship and a long-lasting civil war. The government should therefore endeavour to recreate political stability and democracy and respect for property rights. In the political arena there still remains a lot to be done (see Hansson, 1997) before we can classify the country as democratic. Given Ethiopia's history it is understandable that people are reluctant to speak their mind or to criticize the government, and the government certainly does not encourage free debate.

When resources were shifted to the army during the Derg, the rule of law deteriorated, the cost of enforcing contracts increased, and the security of property rights was eroded. Civil liberties were suppressed and this contributed to a deterioration in the effectiveness of public expenditures since people were reluctant to speak out about public waste and inefficiency. After the civil war the new government has tried to restore an environment for economic recovery. Ethiopia is less corrupt than most countries in the region, and that is a positive characteristic of the state. However, unless the government lets civil society thrive, then it will be hard to create an atmosphere of openness that will encourage investors and entrepreneurs. Stability and security of property rights cannot in the longer term be built on the basis of a regime with dubious legitimacy and a narrow power base.

We have noted that security of property rights is an essential prerequisite for investment. One example of insecure property rights in Ethiopia is that all land is owned by the state,

and the user has only usufructuary rights (Ayalew *et al*, 1999). This reflects the nationalization of land under state socialism, a problem common to all the countries in this UNU/WIDER project (Addison, 1998). Land distribution is fairly even in Ethiopia, but tenancy arrangements are very far from conducive to productivity enhancing investments in agriculture (a similar problem exists in Eritrea, see Kibreab, 2000). Tillers cannot be sure that they will be able to reap the benefits of, for example, soil conservation measures (Tekie Alemu, 1999). Nor can land be used as collateral, which may reduce the efficiency of the credit market. These issues, while politically difficult, must be resolved.

9. Conclusions

The basic ingredients in what is now considered to be the appropriate strategy necessary to achieve growth in Africa are openness and careful fiscal management. Within this framework, however, growth should preferably be based on agriculture in a country like Ethiopia, since this is where the bulk of the poor are to be found.

The starting point of this paper's analysis has been that Ethiopia is an extremely underdeveloped country, where needs are large and resources are seriously constrained. Poverty interventions therefore need to be as cost-effective as possible, and this principle has guided us in the discussion of policy choices. Since the restoration of peace Ethiopia has adjusted public-sector resource-use in a pro-poor direction. Despite this it is the better off that have largely reaped the rewards of the economy's accelerated growth. Trickle-down has been limited. The government therefore needs to further sharpen its poverty focus. We have emphasized that this requires access to good household data, and other community-level information. The situation in this respect has improved somewhat in Ethiopia, but there are obviously still large information gaps.

We have discussed a range of areas, which we feel are particularly important for the poor in the context of Ethiopia. Some of the points that we raise are not new - but they are no less important for that - but we do feel that it is more important to concentrate on basic needs than to try new fancy ideas. Thus, top priority should be given to the creation of a rural road network, but the provision of water and electricity are also important (and all these investments must be designed to maximize poverty reduction). Improvements in these sectors will boost agriculture, but they need to be backed up by an appropriate credit system, extension advice and a functioning input-supply system. Within the area of human capital development the situation in Ethiopia is one of SSA's worst. In the area of education we have suggested that one should attempt novel methods of community based educational methods to get a quick increase in the enrolment rates which at present are at disastrously low levels. In the area of health services we have argued that the cost-effective option is to improve the quality of the existing facilities rather than to build new ones. Resources for public safety nets are limited, and social security will mainly have to be provided by the extended family or the local community. However, there may still be scope for some forms of safety nets for the completely destitute on the one hand, and for victims of economic shocks (mainly drought) on the other. However, given the government's limited resources and problems in administrative capacity, these types of precautions may have to be backed up by donors and NGOs.

In the longer term poverty reduction has to be based on economic growth. The preservation

of a growth-friendly environment is therefore crucial. This implies that the level of taxation cannot be too much out of line with that in similar countries (although more can be done to improve the efficiency of tax collection), and this in turn means that the scope for direct poverty interventions will remain tightly constrained. The types of measures proposed in this paper can over time absorb large resources, but their expansion will have to be limited to what is feasible given the budget. The dismantling of the socialist system and the restoration of peace over 1992-98 have made it possible to significantly expand activities with relevance to the poor. But the present war with Eritrea threatens to undermine progress. If the war can be brought to an end, the prospects for poverty reduction in Ethiopia are considerable.

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